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Neil E. Harl
Iowa State University

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Robert P. Achenbach, Jr.
Contributing Editor
Dr. Neil E. Harl, Esq.

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HANDLING JOINT TENANCIES AT DEATH

— by Neil E. Harl*

It took nearly a decade, but the Internal Revenue Service has finally acknowledged the line of cases headed by *Gallenstein v. United States*[1] and followed by five more cases[2] holding that the so-called "consideration-furnished" rule of federal estate taxation of jointly-owned property[3] could be applied at the first death of a husband-wife joint tenancy to produce a higher income tax basis in the hands of the surviving joint tenant.[4] IRS has now acquiesced in the Tax Court decision, *Hahn v. Commissioner,*[5] which removes the remaining doubt as to whether application of the consideration-furnished rule was acceptable in the case of husband-wife joint tenancies.[6] In *Hahn v. Commissioner*,[7] The Tax Court agreed that a surviving spouse could be entitled to a new income tax basis on 100 percent of the date of death value for property held in joint tenancy with a predeceased spouse.[8]

Facts in Hahn v. Commissioner

In *Hahn v. Commissioner*,[9] the husband, who was the first of the joint tenants to die, in 1972 had signed an agreement to purchase shares in a corporation representing an apartment. The shares were issued later to the husband and wife in joint tenancy. At the husband's death, in 1991, the wife became the sole owner of the shares. The federal estate tax return included 100 percent of the value of the shares in the husband's estate. That amount was, of course, covered by the federal estate tax marital deduction.[10] On later sale of the shares, the wife (as the surviving joint tenant) claimed an income tax basis of $758,412. On audit, the Internal Revenue Service took the position that only 50 percent of the date of death value should have been included in the husband's estate and, therefore, only that amount should have received a new basis at the husband's death. The Tax Court disagreed.

History of the "consideration furnished" rule

Before 1977, the value of joint tenancy property was subject to federal estate tax in the estate of the first to die except to the extent it could be proved that the survivor contributed to its acquisition.[11] This became known as the "consideration furnished" rule.[12]

Before 1982, the creation of husband-wife joint interests in land was not subject to federal gift tax unless so reported on a gift tax return timely filed.[13]

An important point in *Hahn v. Commissioner*[14] and the other cases is that whatever portion of asset value is included in the decedent's gross estate also receives a new income tax basis at death.[15] A surviving joint tenant is considered to have acquired property from the decedent only to the extent that the property

* Charles F. Curtiss Distinguished Professor in Agriculture and Professor of Economics, Iowa State University; member of the Iowa Bar.

was required to be included in the estate of the deceased joint tenant.[16] Thus, the portion of the property not included in the decedent's estate retains the survivor's income tax basis.

The "fractional share" rule

In 1976, the joint tenancy rule[17] was amended to create a special rule for joint tenants who were husbands and wives married to each other.[18] Under that rule, one-half the value was included in the estate of the first to die without regard to which spouse furnished the consideration to acquire the jointly-held property. Moreover, one-half the value received a new income tax basis at death.[19]

Applicability of "consideration furnished" rule before 1982

The key question has been whether the "consideration furnished" rule continued to apply in the case of deaths after 1981. That question was first answered by *Gallenstein v. United States*[20] in 1992 and confirmed by the other cases decided since 1992[21] including *Hahn v. Commissioner*.[22] The *Gallenstein* case[23] concluded that Congress had not repealed the "consideration furnished" rule for husband-wife joint tenancies either expressly or by implication.[24] Indeed, in *Hahn v. Commissioner*,[25] the court concluded that the "fractional share" rule "does not apply to spousal joint interests created before January 1, 1977."[26]

To what property does *Hahn* apply?

For federal gift tax purposes, by the general rule a gratuitous transfer of property by one person to that person and another as joint tenants is considered a gift of a proportionate part of the value.[27] Before January 1, 1977, only three classes of property did not involve a gift when acquired by a husband and wife in joint tenancy—(1) the purchase of United States savings bonds registered as payable to the one providing the consideration "or" another did not (and still does not) constitute a taxable gift until and unless the one not providing consideration redeems the bond during the lifetime of the other without any obligation to account for the proceeds to the other owner;[28] (2) the transfer of funds into a joint bank account did not (and still does not) produce a taxable gift until and unless the one not providing funds withdraws amounts for his or her own benefit;[29] and (3) through 1981, for a joint tenancy in real property created after December 31, 1954, in a husband and wife, by one of the spouses, a taxable gift did not result at the time of the transfer unless the donor elected to treat the transfer as a gift.[30] Contribution was defined in terms of "money, other property or an interest in property."[31]

Thus, these three types of categories of property appear eligible for application of the "consideration furnished" rule[32] at the death of the first to die of a husband and wife joint tenancy, although only the land exception is of much interest. Of course, it is necessary for the spouse who provided the consideration to die first in order for the surviving spouse to benefit from a new basis for up to 100 percent of the value of the property. Note that if assets had declined in value, and death of the first to die would result in a step-down in basis, the fractional share rule would result in a more advantageous result for the survivor. However, *Hahn v. Commissioner*[33] states that "…section 2040(b)(1) [the "fractional share" rule] does not apply to spousal joint interests created before January 1, 1977."[34]

Who can use *Hahn v. Commissioner*?

Obviously, in the estate of the first to die of a husband-wife joint tenancy, if the estate applied the "consideration furnished" rule (for acquisition of eligible property before 1977 when the first to die contributed the consideration), the rule of *Hahn v. Commissioner*[35] can be applied. What if the estate of the first to die was not sufficiently large to file a federal estate tax return? In that case, it would appear that, so long as an inconsistent position was not taken after the first death (and the facts otherwise support application of the "consideration furnished" rule), the "consideration furnished" rule could be applied. An "inconsistent position" could possibly have been taken on a depreciation schedule as the schedule was adjusted after death of the first joint tenant to die or on a state inheritance tax return in a state with rules for joint tenancy taxation similar to the federal rules. These possibilities await further illumination in rulings or cases or both.

FOOTNOTES

1 91-2 U.S. Tax Cas. (CCH) ¶ 60,088 (E.D. Ky. 1991), *aff'd*, 975 F.2d 286 (6th Cir. 1992).

2 Patten v. United States, 96-1 U.S. Tax Cas. (CCH) ¶ 60,231 (W.D. Va. 1996), *aff'd*, 116 F.3d 1029 (4th Cir. 1997); Anderson v. United States, 96-2 U.S. Tax Cas. (CCH) ¶ 60, 235 (D. Md. 1996); Baszto v. United States, 98-1 U.S. Tax Cas. (CCH) ¶ 60,305 (M.D. Fla. 1997); Hahn v. Comm'r, 110 T.C. 140 (1998, *acq*. AOD CC-2001-06. See Wilburn v. United States, 97-2 U.S. Tax Cas. (CCH) ¶ 50,881 (D. Md. 1997) (widow could amend husband's estate tax return to include entire value of real estate owned in tenancy by entirety).

3 I.R.C. § 2040(a).

4 See generally 5 Harl, *Agricultural Law* § 43.02[2] (2001); Harl, *Agricultural Law Manual* § 5.02[1] (2001).

5 110 T.C. 140 (1998).

6 See Harl, "Basis for Joint Tenancy Property," 9 *Agric. L. Dig.* 49 (1998).

7 See note 5 *supra*.

8 *Id*.

9 *Id*.

10 I.R.C. § 2056.

11 I.R.C. § 2040(a). See, e.g., Estate of Hatchett v. Comm'r, T.C. Memo. 1989-637 (estate met burden of proof to extent of one-quarter of value that was attributable to surviving spouse's inheritance from parent).

12 See 5 Harl, supra note 4, § 43.02[2][b] (2001); Harl, *Agricultural Law Manual* § 5.02[1] (2001).

13 I.R.C. § 2515, before repeal by Pub. L. 97-34, Sec. 403(c)(3)(B), 95 Stat. 302 (1981).

14 110 T.C. 140 (1998), *acq*., AOD CC-2001-06.

15 See notes 1 and 2 *supra*.

16 See I.R.C. § 1014(a).

17 I.R.C. § 1014(b)(9).

18 I.R.C. § 2040.

19 I.R.C. § 2040(b), added by Tax Reform Act of 1976, 90 Stat. 1520, 1855.

[20] I.R.C. §§ 1014(a)(1), 1014(b)(9).

[21] 975 F.2d 286 (6th Cir. 1992) (entire value entitled to new income tax basis).

[22] See cases cited in note 2 *supra*.

[23] 110 T.C. 140 (1998), *acq.*, AOD CC-2001-06.

[24] 975 F.2d 286 (6th Cir. 1992).

[25] *Id*.

[26] 110 T.C. 140 (1998), *acq.*, AOD CC-2001-06.

[27] *Id*.

[28] Treas. Reg. § 25.2511-1(h)(4). See First Wisconsin Trust Co. v. United States, 553 F. Supp. 26 (E.D. Wis. 1982) (stock transferred to "street account" with brokerage firm).

[29] Treas. Reg. § 25.2511-1(h)(4).

[30] See Treas. Reg. § 25.2515-1(b).

[31] Treas. Reg. § 25.2515-1(c).

[32] Treas. Reg. § 25.2515-1(c)(1)(i).

[33] I.R.C. § 2040(a).

[34] 110 T.C. 140 (1998), *acq.*, AOD CC-2001-06.

[35] *Id*.

[35] 110 T.C. 140 (1998), *acq.*, AOD CC-2001-06.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

FEDERAL TAX-*ALM* § 13.03[7].*

DISCHARGE. The debtor had pled guilty for violation of 18 U.S.C. § 371 for conspiracy to impair the lawful functions of the IRS by failing to report income. The debtor sought to discharge the tax on that unreported income and the IRS argued that the taxes were nondischargeable under Section 523(a)(1)(C) for willful attempt to evade taxes. The court held that the debtor was collaterally estopped by the debtor's guilty plea to the conspiracy charge from denying that the debtor had willfully attempted to evade the taxes; therefore, the taxes were nondischargeable. ***In re* Summers, 266 B.R. 292 (Bankr. E.D. Penn. 2001)**.

The debtor had severed as executor of a decedent's estate which had failed to fully pay federal estate taxes. The IRS had filed suit against the debtor for payment of those taxes and that suit was pending when the debtor filed for Chapter 7. The IRS argued that the taxes were nondischargeable under Section 523(a)(4) as a debt resulting from fraud or defalcation while acting in a fiduciary capacity. The debtor argued that the IRS lacked standing to challenge the dischargeability of the taxes because the debtor did not owe any fiduciary duty to the IRS. The court looked to Texas law and held that an executor's fiduciary duty extends to all who have an interest in the decedent's estate; therefore, the IRS had sufficient standing to raise the issue. The court held that the debtor's liability for the estate taxes was not dischargeable. ***In re* Tomlin, 266 B.R. 350 (N.D. Tax. 2001)**.

CONTRACTS

HEDGE-TO-ARRIVE CONTRACTS. The Chapter 12 debtor was a farmer who had entered into several hedge-to-arrive contracts which provided for delivery of grain but allowed the debtor to rollover the delivery of the grain to subsequent years. The contracts also contained clauses which required all disputes involving the contracts to be arbitrated under the National Grain and Feed Association arbitration rules. After the debtor defaulted on the contracts, the buyer obtained a state court judgment to enforce the arbitration provisions and the parties submitted the dispute to arbitration. The arbitration panel ruled that the hedge-to-arrive contracts were enforceable and not illegal off-exchange futures contracts because actual delivery of the grain was intended. The buyer filed a claim in the bankruptcy case based on the arbitration award. The debtor sought to challenge the claim on the basis that the arbitration award was improper because of industry bias of the arbitration panel and because the hedge-to-arrive contracts were illegal off-exchange futures contracts. The court held that the debtor failed to prove that the arbitration panel was biased or exceeded its authority and also upheld the panel's ruling that the contracts were enforceable. ***In re* Robinson, 265 B.R. 722 (Bankr. 6th Cir. 2001)**.

WARRANTY. The plaintiff purchased a used tractor from the defendant. The tractor immediately had mechanical problems and after six months of attempting to fix these problems and 160 hours of use, the plaintiff sued for breach of express and implied warranties, fraud, misrepresentation and deceit. The trial court held that the tractor had defective o-rings and the implied warranties of merchantability and fitness for a particular purpose had been breached. The appellate court held that sufficient evidence was presented to support the trial court's ruling that the tractor had defective o-rings which caused the mechanical problems. The defendant argued that the plaintiff waited too long to claim that the implied warranties of merchantability and fitness for a particular purpose had been breached. The court held that, considering the plaintiff's difficulty in determining the actual problem, the amount of time between the purchase of the tractor and the suit to recover damages was reasonable. **Eggl v. Letvin Equip. Co., 632 N.W.2d 435 (N.D. 2001)**.